Legislative Audit Division

State of Montana

Report to the Legislature

September 1997

Financial-Compliance Audit

For the Fiscal Year Ended June 30, 1997

Guaranteed Student Loan Program

Commissioner of Higher Education

We issued an unqualified opinion on the financial statements of the program and our report contains no recommendations.

Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act of 1984 and Amendments of 1996, and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1995 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

September 1997

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial-compliance audit of the Commissioner of Higher Education's Guaranteed Student Loan Program (GSLP) for the fiscal year ended June 30, 1997.

The Montana Guaranteed Student Loan Program was authorized by the Montana Legislature in 1979 and established July 1, 1980. The GSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by lending institutions and makes administrative cost reimbursements to the GSLP. Prior audit concerns about the operations of the GSLP in future years have diminished, as discussed in note 22 on page A-15 of the notes to the financial statements.

The Guaranteed Student Loan Program initially contracted with United Student Aid Funds, Inc. to process and service loans. In 1988, the Montana GSLP began assuming the administrative duties associated with the loan guarantee process. During 1990 the GSLP assumed complete administrative control but continues to contract with USA Services, Inc. for computer support services.

We thank the Commissioner of Higher Education and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

“Signature on File”

Scott A. Seacat
Legislative Auditor

Room 135, State Capitol Building, PO Box 102705 Helena MT 59620-1705
Phone (406)444-3122, FAX (406)444-9784

Legislative Audit Division

Financial-Compliance Audit
For the Fiscal Year Ended June 30, 1997

Guaranteed Student Loan Program

Commissioner of Higher Education

Members of the audit staff involved in this audit were Jim Manning and Vickie Murphy.

Table of Contents

Administrative Officials

Administrative Officials	Dr. Richard Crofts	Commissioner of Higher Education
	Stuart Knapp	Deputy Commissioner for Academic Affairs
	Rod Sundsted	Associate Commissioner for Fiscal Affairs
	Laurie O. Neils	Director of Budget and Accounting
	Arlene Hannawalt	Director of Guaranteed Student Loan Program
	Rosemary Harmon	Accounting and Fiscal Manager of the Guaranteed Student Loan Program

Guaranteed Student Loan Program

We performed the financial-compliance audit of the Montana Guaranteed Student Loan Program for the fiscal year ended June 30, 1997. This report contains the audited financial statements and accompanying notes for fiscal year 1997. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

The current report contains no recommendations to the program. The prior report also contained no recommendations.

Independent Auditor’s Report
& Program Financial Statements

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the Balance Sheet of the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1997, and the related Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual for the fiscal year then ended. These financial statements are the responsibility of the program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund and are not intended to present fairly the financial position and results of operations of the state of Montana in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

"Signature on File"

James H. Gillett, CPA
Deputy Legislative Auditor

August 22, 1996

COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
BALANCE SHEET
JUNE 30, 1997

ASSETS	
Cash in Treasury	$540,511
Accounts Receivable	45,515
Due From Federal Government (Note 2)	6,122,490
Loans To Students (Note 3)	12,086
Investments (Note 4)	4,914,800
Securities Lending Cash Collateral (Note 5)	132,322
Prepaid Expense	295
Total Assets	$11,768,019
LIABILITIES AND FUND BALANCE	
Liabilities:	
Accounts Payable	$297,318
Liabilities Under Securities Lending (Note 5)	132,322
Property Held in Trust (Note 6)	104,504
Due to Federal Government (Note 7)	1,188,004
Deferred Revenue (Note 8)	4,071,268
Total Liabilities	$5,793,416
Fund Balance	5,974,603
Total Liabilities and Fund Balance	$11,768,019

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
MONTANA GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

	Budget	Actual	Variance Favorable/ (Unfavorable)
REVENUE:			
Guarantee Fee Income (Note 8)	$1,331,400	$1,331,214	($186)
Administrative Expense Allowance (Note 9)	500,000	750,784	250,784
Investment Earnings (Note 4)	400,000	339,086	(60,914)
Collection Costs Retained (Note 10)	800,000	1,060,893	260,893
Supplemental Preclaims Assistance (Note 11)	170,000	310,798	140,798
Accrued Interest (Note 12)	30,000	39,056	9,056
Nonreinsured Loan Recoveries (Note 13)	5,000	47,082	42,082
Escrow Disbursement Service Fees (Note 6)	50,000	63,060	13,060
Net Securities Lending Income over Exp.(Note 5)	0	1,305	1,305
Miscellaneous Revenue	5,000	8,629	3,629
TOTAL REVENUES	$3,291,400	$3,951,907	$660,507
EXPENDITURES:			
Administrative Costs	$3,344,551	$2,654,289	$690,262
Agency Share of Loan Defaults (Note 13)	50,000	131,433	(81,433)
Equipment and Intangible Assets	26,820	215,778	(188,958)
Debt Service	5,000	3,748	1,252
TOTAL EXPENDITURES	$3,426,371	$3,005,248	$421,123
Excess Revenues Over/ (Under) Expenditures	($134,971)	$946,659	$1,081,630
Prior Year Adjustment (Note 16)	0	(1,720)	(1,720)
Fund Balance - 07/01/96	5,029,664	5,029,664	0
Fund Balance - 06/30/97	$4,894,693	$5,974,603	$1,079,910

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 1997

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program

The State of Montana's Guaranteed Student Loan Program (MGSLP) is located in the Office of the Commissioner of Higher Education. As a Special Revenue Fund, it accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. MGSLP was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions within the State of Montana. Montana's Federal Family Education Loan Program operates in compliance with agreements with the U.S. Department of Education (DE), pursuant to Section 428 of the Higher Education Act of 1965, as amended (The Act).

B. Basis of Accounting

The financial statements were prepared using the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recorded on the basis of valid obligations. Revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year end.

2. DUE FROM FEDERAL GOVERNMENT

MGSLP pays individual lending institutions for any loans that have been defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The agency then seeks reimbursement from DE in accordance with reinsurance agreements between the agency and DE (See Note 13). MGSLP's claims for reinsurance payments not received as of June 30, 1997, are included here.

In addition, the receivable Due From Federal Government includes amounts MGSLP had not yet received for administrative expense allowance payments (Note 9) for the last two quarters of fiscal year 1997, and supplemental preclaims assistance (SPA) reimbursements (Note 11) for accounts which were satisfactorily brought current in the last three months of fiscal year 1997. The extent of the outstanding reinsurance activity and other pending reimbursements from DE as of June 30, 1997, is shown below.

Reinsurance claims due from DE	$5,881,496
Administrative Expense Allowance for the last two fiscal quarters	119,924
SPA for April, May, and June, 1997	121,070
Total Due From Federal Government	$6,122,490

3. LOANS TO STUDENTS

In exceptional circumstances, MGSLP has purchased student loans from lenders, prior to any claim being filed, when the borrower is under extreme financial hardship. MGSLP has waived the borrower's responsibility to cover loan interest costs and is holding the loans in a repayment forbearance pending an improvement in the borrower's financial situation. MGSLP has not received reinsurance from DE on these loans.

4. INVESTMENTS

Investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are reflected at cost, which equals market. At June 30, 1997, MGSLP owned 4,914,800 units valued at $1 per unit for a total of $4,914,800. During fiscal year 1997, MGSLP had investment earnings of $339,089. STIP securities include Banker's Acceptances, Commercial Paper, Corporate Obligations, Montana Certificates of Deposit, Government Securities, and Repurchase Agreements. At June 30, 1997, most securities, classified as Risk Category 1, were held by the state or its agent in the state's name. The remaining portions, classified as Risk Category 2, were loaned under a security lending agreement with the state's agent.

The State of Montana's STIP investment portfolio contained asset-backed securities and variable rate securities with market values of $349,279,592 and $357,015,384; 32.08% and 32.79%, respectively, of the total portfolio at June 30, 1997. Board of Investment policy requires that STIP investments have the highest rating in the short term category by at least one of the six Nationally Recognized Statistical Rating Organizations.

Asset-backed securities have less credit risk than securities not backed by pledged assets and market risk for these securities is the same as market risk for similar non asset-backed securities. While variable-rate securities have credit risk identical to similar fixed-rate securities, their market risk is more sensitive to interest rate changes. Market risk may be less volatile than fixed-rate securities because the value of variable-rate securities will usually remain at or near par. There are no legal risks that the Board of Investments is aware of regarding any STIP investments.

5. SECURITIES LENDING

Under the provisions of state statutes, the Board of Investments has, via, a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal year 1997, State Street lent, on behalf of the Board, certain securities held by State Street, as custodian, and received US dollar currency cash, US government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal year 1997 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal year 1997. Moreover, there were no losses during fiscal year 1997 resulting from a default of the borrowers or State Street.

During fiscal year 1997, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. On June 30, 1997, the Board had no credit risk exposure to borrowers.

6. PROPERTY HELD IN TRUST

MGSLP operates an escrow disbursement service for approximately forty lenders. Participating lenders are assessed a fee for this service. In accordance with contracts MGSLP has with the disbursement service lenders, MGSLP automatically debits the lenders' accounts to collect loan proceeds. MGSLP then disburses funds to the schools for delivery to the students either by individual State of Montana warrants or electronic transfers. The MGSLP disbursement service records all adjustments to individual student loan accounts and ensures that school refunds of loan proceeds are promptly returned to the lenders. Disbursement service revenues earned during fiscal year 1997 were $63,060. As of June 30, 1997, MGSLP's disbursement service held $104,504 in student loan funds which were disbursed to the schools or refunded to the lenders after June 30, 1997.

7. DUE TO FEDERAL GOVERNMENT

After assignment to the guaranty agency, MGSLP seeks collection of student loans that have been defaulted. Recoveries of loans reinsured by DE are owed back to DE (See Note 10). In addition, proceeds of loans sold back to lending institutions after a loan is rehabilitated or repurchased are also owed back to DE. At June 30, 1997, the amount owed to DE is $1,188,004.

8. DEFERRED REVENUE AND GUARANTEE FEE INCOME

Guarantee fees are received from borrowers at the time loans are disbursed. In all years prior to fiscal year 1995 MGSLP charged a guarantee fee equivalent to 3% of the loan amount. Effective July 1, 1994, the maximum guarantee fee that borrowers may be charged decreased to 1% of the loan amount. Guarantee fees are deferred and recognized as revenue, using the straight-line method, over an eight year period. This period approximates the average life of an outstanding student loan. Deferred revenues from guarantee fees are invested by MGSLP and are included in the agency's reserves. Deferred revenue at June 30, 1997, is $4,071,268.

Earned guarantee fee income for the fiscal year is made up of the annual guarantee fees received as follows:

Fiscal Year	One-eighth of fees
1990	$ 166,654
1991	181,017
1992	203,310
1993	218,329
1994	260,288
1995	107,525
1996	93,045
1997	101,046
	$1,331,214

9. ADMINISTRATIVE EXPENSE ALLOWANCE

The Omnibus Budget Reconciliation Act of 1993 provides that payment of Administrative Expense Allowance (AEA) is dependent upon federal appropriation on an annual basis. AEA reimbursements are calculated as 0.85% of the total consummated loan guarantees made during the quarter. During fiscal year 1997 AEA payments totaled $750,784 which includes $119,924 for loan guarantee expense reimbursements which were not received until after June 30, 1997.

10. COLLECTION COSTS RETAINED

MGSLP pursues collection, from the borrower or other responsible party, of defaulted loans held by the agency. The U.S. Secretary of Education is entitled to his equitable share of any recoveries, as determined by the rate of reinsurance on the defaulted loans less an allowance for collection cost reimbursement. The Budget Reconciliation Act of 1993 established the agency's collection cost retention rate at 27%. In addition, the Secretary provides the agency with collection costs amounting to 18.5% of the outstanding balance of any defaulted loan held by the agency which is consolidated by the borrower into a Federal Direct Consolidation Loan. During fiscal year 1997 MGSLP retained $1,060,893 in collection costs from loan recoveries and direct loan consolidations.

11. SUPPLEMENTAL PRECLAIMS ASSISTANCE

Supplemental Preclaims Assistance (SPA) is a default prevention measure provided by MGSLP to borrowers that are between 120 and 270 days delinquent on their student loan payments. Delinquent borrowers are contacted to advise them of options available to bring their delinquent accounts current. After a borrower successfully brings his/her account current, DE reimburses MGSLP for its SPA activities. The reimbursement is computed as 1% of the outstanding delinquent account balance brought current. Reimbursements for SPA during fiscal year 1997 were $310,798. This includes $121,070 in reimbursements for supplemental preclaims activity during the last three months of the year, which were not received until after June 30, 1997.

12. ACCRUED INTEREST

MGSLP purchases claim eligible bankruptcy accounts from lending institutions. If the claim survives the bankruptcy discharge, MGSLP sells the bankruptcy claim back to a lending institution at its outstanding value, including interest which accrued during the bankruptcy proceedings. During fiscal year 1997, accrued interest earned on repurchased bankruptcy accounts was $39,056.

13. CONTINGENCIES

The outstanding principal balance of loans guaranteed by MGSLP as of June 30, 1997, is approximately $498,746,000. This amount excludes bad debt, death, disability, and bankruptcy claims which have been previously purchased by the agency.

MGSLP has entered into agreements with DE, dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with The Act. These agreements allow for 100% reimbursement by DE for claims due to the death, disability, or bankruptcy of the borrower. Claims due to defaulted loans may be reimbursed by DE for up to 100%. The percent of reimbursement on defaulted loans payable to the agency is dependent upon MGSLP's annual default rate and date of the original loan guarantee. Annual default rates are calculated as the ratio of year-to-date default purchases divided by the original guaranteed amount of loans in repayment status at the beginning of the federal fiscal year. MGSLP's annual default rate has been less than 5% since the conclusion of the 1987 federal fiscal year on September 30, 1987. The following schedule reflects the federal reinsurance rates on defaulted student loans. In the event of extreme future adverse loss experience, MGSLP could be liable for up to 22% of the outstanding loan volume. Since its inception, MGSLP has paid $388,894 in claims which were not reinsured by DE. This includes $131,433 in non-reinsurable claims purchased during fiscal year 1997. MGSLP recovered $47,082 of the total outstanding balance of non-reinsured claims held by the agency during fiscal year 1997.

RATE OF ANNUAL DEFAULTS	FEDERAL REINSURANCE Loans made on or prior to 9/30/93	FEDERAL REINSURANCE Loans made on or after 10/1/93
0 to 5%	100%	98%
more than 5% but less than or equal to 9%	100% of claims thru 5%; 90% of claims over 5% but less than or equal to 9%	98% of claims thru 5%; 88% of claims over 5% but less than or equal to 9%
over 9%	100% of claims thru 5%; 90% of claims over 5% but less than or equal to 9%; 80% of claims over 9%	98% of claims thru 5%; 88% of claims over 5% but less than or equal to 9%; 78% of claims over 9%

14. LOSS CONTINGENCY FROM DEFAULTED LOAN CONSOLIDATIONS

Section 428(c)(6) of The Act provides that a guaranty agency is authorized to retain an amount of any borrower payments received by the guaranty agency on a defaulted loan. The amount retained is equal to the sum of the complement of the reinsurance percentage in effect when the Secretary paid the reinsurance claim plus 27% of the payment amount to cover administrative costs related to collection and default prevention (See Note 10). Under section 428C of The Act, a defaulted borrower is permitted to acquire a Federal Consolidation Loan and apply the proceeds to pay the balance due on his/her defaulted loans.

Although not supported by law or regulation, DE has stated that the payoff amount received by a guaranty agency for a defaulted loan included in a Federal Consolidation Loan is not a payment "made by the borrower", as the term is used in section 428(c)(6). DE claims that The Act does not specifically authorize guaranty agencies to retain any part of the payoff amount on defaulted loans that are consolidated.

MGSLP does not agree with DE's position. MGSLP maintains that DE's interpretation of a payment "made by the borrower" is too narrow and that loan payoffs resulting from consolidation should be subject to agency retention as it is defined in section 428(c)(6) of The Act until a change in regulation or law differentiates an alternate retention rate. The 1996 Amendments to The Act, which become effective July 1, 1997, change the collection retention rate on default loan consolidation payoffs to 18.5%. MGSLP, in conjunction with other guaranty agencies across the country, are seeking resolution with DE on this issue. Currently, no legal action has been taken by any party. MGSLP believes the possibility that the agency will be required to pay DE an additional portion of the consolidated, defaulted loan payoffs is remote. The amount of this contingent loss is approximately $328,000 and has not been included in the financial statements due to its unlikely realization.

15. COMMITMENTS

MGSLP is bound by Guarantee Reserve Agreements with the lending institutions participating in the Federal Family Education Loan Program in Montana. These agreements require MGSLP to maintain an amount in the guarantee reserve fund equal to at least 1.0% of the unpaid principal balance of all outstanding loans guaranteed by the agency. MGSLP's Guarantee Reserve Agreement with the Montana Higher Education Student Assistance Corporation (MHESAC), Montana's student loan secondary market, has been amended to require that its reserve fund be equal to at least 1.5% of the unpaid principal balance of all outstanding loans guaranteed by MGSLP.

The Guarantee Reserve Agreement ensures that MGSLP will have sufficient cash available to carry out its reasonably expected obligations on guaranteed claim eligible student loans. As of June 30, 1997, MGSLP was substantially in compliance with all Guarantee Reserve Agreements.

16. PRIOR YEAR ADJUSTMENTS

Prior year adjustments, totaling $1,720, consists of an adjustment to revenue earned during fiscal year 1996 which was over accrued at fiscal year end ($1,226); payment for supplies which were received in fiscal year 1996 but not billed until fiscal year 1997 ($182); and payment for lease expenses incurred in fiscal year 1996 ($312).

17. FIXED ASSETS

MGSLP is accounted for on the Statewide Budgeting and Accounting System (SBAS) as a special revenue fund. The fixed assets of MGSLP, which total $655,443 as of June 30, 1997, are valued at cost. MGSLP fixed assets are included in the General Fixed Assets Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

18. COMPENSATED ABSENCES LIABILITY

MGSLP's liability for compensated absences, which totals $95,568 as of June 30, 1997, is included in the Long Term Debt Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

19. LEASES

MGSLP has entered into an operating lease for office facilities and a capital lease for a photocopier. The operating lease, which expires in November 2008, had total rental payments during fiscal year 1997 of $149,266.

The balance of the capital lease at June 30, 1997 was $2,596. Total payments to principal during fiscal year 1997 were $1,384.

Future minimum lease payments under the lease agreements are as follows:

Fiscal Year	Operating	Capital Lease	
Ending June 30	Lease	Principal	Interest
1998	$141,059	$2,843	$905
1999	140,875	3,114	635
2000	140,633	3,410	338
2001	140,643	1,825	49
2002	141,100	-	-
2003+	900,525	-	-

20. RELATED PARTY TRANSACTIONS

The Montana Board of Regents, which governs MGSLP, is the guarantor of the loans owned by MHESAC. The Board of Regents and MHESAC have four common board members. Approximately 55.3% of MGSLP's outstanding loan volume is held by MHESAC.

MGSLP has an agreement with MHESAC to share certain costs for the lease of computer equipment; computer and software maintenance costs; computer supply, photocopy, and facsimile expenses; and personnel costs for employees of MHESAC who perform services that are of direct benefit to MGSLP. Certain MHESAC personnel are authorized to purchase computer equipment for use by both MGSLP and MHESAC. Costs for these purchases are covered under the shared costs agreement between the two entities. MGSLP also receives certain services from the State of Montana for telephone, postage, and computer supplies which directly benefit MHESAC. MHESAC reimburses MGSLP for these services.

During fiscal year 1997, MGSLP's portion of shared costs reimbursed to MHESAC was $358,821, including $61,174 which was not paid until after June 30, 1997. MGSLP was reimbursed for $218,579 of shared costs by MHESAC, which includes an accrued receivable of $32,076 for reimbursements not received until after June 30, 1997.

21. EMPLOYEES' RETIREMENT SYSTEM

MGSLP employees are covered by the Public Employees Retirement System (PERS) or the Teachers Retirement System (TRS). Professional employees with contracts under the authority of the Board of Regents may choose either the Montana Teachers Retirement System (TRS) or the Optional Retirement Program (ORP), which is available through the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF). The classified staff is provided a retirement program through the Montana Public Employees Retirement System (PERS).

DEFINED BENEFIT PLANS

Public Employees Retirement System (PERS).

Established in 1945 and governed by Title 19, Chapter 3, MCA, Public Employees Retirement System participants are eligible to retire at age 60 with at least five years of service; at age 65 regardless of length of service; or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989, monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals five years. Under PERS, the state contributed 6.700% of an employee's gross wages. The employee contributed 6.700% of his/her gross wages.

Teachers Retirement System (TRS).

The Teachers Retirement System was established in 1937 and is governed by Title 19, Chapter 20, MCA. Teachers Retirement System participants are eligible to retire with a minimum 25 years of membership service or five years of creditable service at age 60. A retirement benefit is 1/60 times the years of service times average final compensation. An employee is vested in TRS following completion of five years of creditable service. Vested employees may retire at or after age 50 and receive a reduced retirement benefit. Under TRS, the state contributed 7.470% of an employee's gross wages. The employee contributed 7.044% of his/her gross wages.

The State's policy is to fund accrued pension costs although unfunded liabilities exist. Based on their most recent actuarial valuation reports, both the PERS and the TRS were actuarially sound.

Trend information, indicating the progress made toward accumulating assets needed to pay retirement benefits when they are due, is not available on an agency basis. This information is available on a statewide basis in the Retirement System's annual reports.

RETIREMENT PLAN INFORMATION FOR MGSLP AS OF JUNE 30, 1997

	PERS	TRS
Covered Payroll	$ 825,851	$ 54,999
Total Payroll	1,142,214	1,142,214
Employer Contributions	$ 55,332	$ 4,108
Percent of Covered Payroll	6.700%	7.470%
Employee Contribution	$ 55,332	$ 3,874
Percent of Covered Payroll	6.700%	7.044%

22. GOING CONCERN

DE operates the Federal Direct Student Loan Program (FDSLP) which directly competes with the Federal Family Education Loan Program (FFELP) for services provided to schools and students. At the conclusion of fiscal year 1996, there was uncertainty within the major Montana schools about which loan program they would participate in. In early fiscal year 1997, the Presidents of these schools announced that for the foreseeable future those schools currently participating in the FFELP would continue to do so. This announcement substantially lessened the uncertainty about MGSLP as a going concern.

23. SUBSEQUENT EVENTS

The Balanced Budget Act of 1997, P.L. 105-33, signed August 5, 1997, provides for the U.S. Secretary of Education to recall $1 billion of guaranty agencies' reserve funds by September 1, 2002. Each agency's required share of the total recalled reserve funds has been calculated based on the total reserve fund dollars held by the agency as of September 30, 1996. In each of the federal fiscal years 1998 through 2002, each guaranty agency must transfer their required share, in equal, annual installments, into a restricted account established by the agency where funds will be held until final transfer to DE. Investment earnings on the restricted reserve fund may be used by the agency on default reduction activities. MGSLP's required share of the total recalled reserves is approximately $4.9 million or 51% of MGSLP's available reserve balance at September 30, 1996. MGSLP does not anticipate a significant impact in its operations until final transfer of its recalled reserves to DE.

In July, 1997, MGSLP reached and exceeded the 5% annual default rate for the federal 1997 fiscal year. (See Note 13). As a result, all default claims MGSLP reports to DE subsequent to reaching the 5% default rate through the end of the federal fiscal year, will be subject to reduced reinsurance from DE. MGSLP anticipates that $1.2 million in default claims will be purchased by the agency during this time resulting in a $120,000 loss in reinsurance.

Program Response

MONTANA GUARANTEED STUDENT LOAN PROGRAM

Mailing Address:
P.O. Box 203101
Helena, MT 59620-3101

(406) 444-6594
FAX (406) 444-1869

Delivery Address:
2500 Broadway
Helena, MT 59601-4989

Customer Assistance (800) 537-7508

September 10, 1997

Scott A. Seacat
Legislative Auditor
Capitol Station
Helena, Montana 59620

Dear Mr. Seacat:

This letter confirms completion of the Montana Guaranteed Student Loan Program's FY97 financial audit which was performed by your staff. It is my understanding there were no recommendations.

I want to take this opportunity to thank you and your staff for the fine spirit of cooperation and professionalism with which the audit was conducted. Please be assured that MGSLP's management and staff will continue to evaluate the operations of the agency as impacted by ever-changing federal legislation. We remain committed to providing the best available services to the students, schools, and lenders participating in the Federal Family Education Loan Program in Montana. Their confidence in the integrity and quality of service provided by MGSLP is of utmost importance to ensure that Montana students are never denied access to private capital for student loans.

Sincerely,

Arlene Hannawalt
Director